

regime is critical.<sup>58</sup> However, as a practical matter, access charge reform does not comprehend an immediate need for separations reform. No flash-cut dislocation of ILEC revenue streams will occur upon release of the Commission's order in this docket.<sup>59</sup> Rather, under TWComm's proposal, the development of downward pressure on interstate access prices will occur gradually. The Commission has ample time to engage in a considered approach to jurisdictional separations reform.

**E. The Proposals Before The Commission Do Not Implicate Regulatory Confiscation.<sup>60</sup>**

TWComm's proposals herein are not confiscatory. They permit ILECs the opportunity to recover historic costs but, as in any competitive market, they do not guarantee the ability to do so. The ILECs will not find themselves unable to attract capital for future investments, as evidenced by the reports of Merrill Lynch and other Wall Street analysts.<sup>61</sup> To the contrary, Wall Street seems bullish on ILECs, despite full anticipation of the potential effects of access charge reform.<sup>62</sup> Hence, TWComm's

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<sup>58</sup> The Commission indicated its intent to initiate a proceeding to reform its jurisdictional separations rules. See Notice at ¶ 6.

<sup>59</sup> Only transport elements are subject to any competitive pressures currently. Any such pressure on remaining access revenue will result from competition for local exchange dialtone services, which will occur gradually over time.

<sup>60</sup> This Subsection relates to Section VII.B. of the Notice.

<sup>61</sup> See MCI Comments at 3-5 (noting financial analysts' positive outlook on future BOC profits).

<sup>62</sup> See MCI Comments at 3 (stating that "financial analysts are anticipating access charge reductions" and citing to Wall

proposal does not constitute confiscation, as judicially defined.<sup>63</sup>

The ILECs, on the other hand, advocate broadening the standard for confiscation. They contend that unless a regulated carrier is guaranteed perpetually the recovery of a profitable return on all ventures (past, present, and future), a taking has occurred.<sup>64</sup> Ratepayers should not be financially burdened, nor should the development of competitive markets be impaired, to realize this unreasonable proposition. The proposals before the Commission do not threaten confiscation, as discussed at length in TWComm's initial comments,<sup>65</sup> and ILEC assertions to the contrary are baseless.

**V. THE COMMISSION SHOULD ALIGN COST RECOVERY WITH COST CAUSATION.<sup>66</sup>**

The Commission's interstate access rate structure impedes the development of exchange access competition insofar as, in

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Street analyses of anticipated BOC earnings in light of access charge reform).

<sup>63</sup> See, e.g., FPC v. Hope Natural Gas Co., 320 U.S. 591, 605 (1944) (rate regulation provides adequate compensation if it "enable[s] [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed."); see also, Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989) (holding that a taking had not occurred because the state law did not jeopardize the ability of the regulated firms to attract capital and compensate investors).

<sup>64</sup> See, e.g., PacTel at 44-46; Bell Atlantic and NYNEX Comments at 16-19.

<sup>65</sup> See TWComm Comments at 46-47.

<sup>66</sup> This Section relates to Section III of the Notice.

many cases, it does not permit recovery of costs from cost causers. The rate structure skews the price signals guiding new entrant investment decisions. The Commission should align cost recovery with cost causation. Restructuring would permit the development of competition which would improve the dynamic efficiencies of the market and ultimately result in reduced prices for end users.

**A. Tandem-Switched Transport Competition Will Not Develop Until The Commission Moves Cost Recovery To Where Costs Are Incurred.<sup>67</sup>**

In its comments, the Competitive Telecommunications Association ("CompTel") notes the absence of competition in the provision of tandem-switched transport and that such competition is unlikely to develop in the foreseeable future.<sup>68</sup> Its proposed solution to this situation is the imposition of prescriptive regulatory action.<sup>69</sup> CompTel correctly identifies current market conditions for tandem-switched transport but misapprehends the cause of the condition and, therefore, suggests an inappropriate solution.

TWComm agrees that tandem-switched transport is not provided competitively. The reason for the current absence of competition

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<sup>67</sup> This Subsection relates to Section III.D and Section III.E of the Notice.

<sup>68</sup> See CompTel Comments at 15 ("[N]o carrier provides competitive tandem switching or tandem-switched transport, and effective competition is not likely to develop in this market segment in the foreseeable future.").

<sup>69</sup> See id.

lies in the fact that a portion of tandem-switched transport costs are recovered through the TIC.<sup>70</sup> Under the interim local transport structure, purchasers of dedicated transport and CAP transport essentially subsidize prices for purchasers of tandem-switched transport through TIC payments assessed in conjunction with end office switching.<sup>71</sup> The below-cost tandem-switched transport pricing by ILECs, made possible by the TIC, precludes efficient entry into that market.

The solution does not necessitate prescriptive regulatory reform. Rather, the Commission must move access charges in a cost-causative direction. Dismantling the TIC and eliminating its subsidy will go far to correct the non-competitive tandem-switched transport market. In doing so, the Commission must ensure that costs for tandem-switched transport are recovered from purchasers of tandem-switched transport.<sup>72</sup> Removal of these costs from the TIC will allow CAPs to serve economically the smaller IXC's relying upon tandem-switched transport for access.

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<sup>70</sup> See USTA Comments at Attachment 10 and Attachment 11 (identifying over \$1 billion in costs that can be reallocated to tandem-switched transport).

<sup>71</sup> See First Report and Order at 7019, ¶ 25 ("In order to ease the impact of a rate structure change on small IXC's, . . . we prescribe that the tandem element initially recover only twenty percent of the current tandem revenue requirement, with the remainder of the revenue requirement recovered through the interconnection charge").

<sup>72</sup> As discussed in TWComm's Comments, to the extent costs are incurred to provide tandem overflow traffic to IXC's primarily utilizing direct-trunked transport, such costs should be recovered from those IXC's through local transport rate elements, not end office rate elements.

**B. The Commission Should Increase The Cap For Residential And Single-Line Business Subscriber Line Charges, Or, In The Alternative, Modify The Carrier Common Line Charge To A Flat-Rate, Per Line Charge.<sup>73</sup>**

TWComm has long advocated an increase in the cap for the residential subscriber line charge ("SLC") as a necessary step toward a more economically rational access charge structure.<sup>74</sup> Due to universal service mandates, the current state and federal rate structures maintain artificially low residential rates against which new facilities-based entrants must compete. Recovery of non-traffic sensitive costs through traffic sensitive rates causes market distortions which create significant entry barriers for a business contemplating the placement of substantial investment in alternative telephony infrastructure in the face of artificially constrained operating margins. Since the recovery of NTS costs on a TS basis shifts cost recovery from residential lines to high-volume, long distance users (i.e., primarily business customers), competitors are given the incentive to base initial entry strategies on the business market. This only serves to delay competitive entry into the residential market and its corresponding benefits to consumers. The problem is only compounded when ILEC services are made available for resale at the steep discounts reflected in the Commission's Local Competition Order<sup>75</sup> and in state arbitration decisions.

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<sup>73</sup> This Subsection relates to Section III.B of the Notice.

<sup>74</sup> Funding Universal Service: Maximizing Penetration and Efficiency in a Competitive Local Service Environment, CC

To provide new entrants with the proper economic signals for entry into the residential service market, rebalancing rates for residential service toward cost is essential. In the context of the Commission's access charge reform proceeding, the most direct vehicle to shift recovery to residential services is the SLC. Unfortunately, despite ample evidence that SLC increases have no impact on universal service objectives, this solution does not appear to be acceptable at this time. As TWComm recommended in its Comments, and as supported by other parties,<sup>76</sup> the next best alternative would be a flat, per-line recovery of current CCLC revenue from IXCs. While the charges would continue to be billed to IXCs, it would shift cost recovery away from high-volume business to the individual line where the cost is incurred.

**VI. THE COMMISSION SHOULD AVOID BURDENING NASCENT CLECS WITH TERMINATING ACCESS REGULATION.<sup>77</sup>**

CLECs are confronted with enormous entry barriers. The 1996 Act and the Commission's Local Competition Order were designed to

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Docket No. 96-45, Comments of Time Warner Communications Holdings, Inc. (filed April 12, 1996); Further Comments of Time Warner Communications Holdings, Inc. (filed Aug. 2, 1996).

<sup>75</sup> Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) ("Local Competition Order"), review pending, sub nom., Iowa Util. Bd., et. al. v. F.C.C., No. 96-3321 (8th Cir. 1996).

<sup>76</sup> See, e.g., USTA Comments at 55; BellSouth Comments at 68. As a policy matter, restructuring the CCL charge to align rates more closely to the manner in which the underlying costs are incurred should be non-optional.

<sup>77</sup> This Section relates to Section VIII.A of the Notice.

reduce the entry barriers imposed by the ILECs. The appeal of the Commission's Local Competition Order foreshadows the continued strong resistance of the ILECs to the reduction of local entry barriers.<sup>78</sup> Despite legislation and Commission orders to reduce entry barriers, their vestiges will continue for some time. In the short term, CLECs will continue to face anticompetitive challenges to local exchange market entry.

In addition to the anticompetitive barriers to entry, CLECs also face the natural financial hurdles of constructing networks and attracting customers. Significant CLEC resources will be devoted to this construction, expenditures which ILECs will not be required to make.

In short, CLECs must devote their resources to confronting the many challenges of local market entry. The Commission should not add to these burdens the regulation of CLEC terminating access. TWComm understands the Commission's concerns that CLECs will overcharge IXCs for terminating access and concedes that this remains a theoretical possibility. However, because no evidence suggests that CLECs will, in fact, engage in this pricing strategy, regulation is premature at this time. Not only is regulation unnecessary, it could be detrimental to the development of both local and access competition in light of the many challenges already confronting CLECs.

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<sup>78</sup> See also, CompTel Comments at 10 ("GTE has appealed every final arbitration award issued by a state regulatory commission to date").

Several commenters have suggested that CLECs be subject to terminating access regulation only if their termination charges exceed those of the ILEC with whom they compete.<sup>79</sup> Once again, TWComm strongly counsels the Commission to avoid placing regulatory burdens on new entrants. The ILEC-baseline approach described above would be appropriate only after actual CLEC terminating access abuses are demonstrated. TWComm suggests that this approach be considered only as a potential future approach and one which is utilized only in the event that unreasonably high CLEC terminating access is shown to be a problem. TWComm remains cautious in its acceptance of this approach due to the burdens it could place on CLECs with legitimately higher cost structures. Nevertheless, this option seems to present a reasonable compromise that satisfactorily addresses the concerns of the Commission and CLECs alike.

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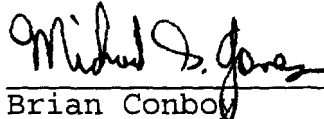
<sup>79</sup> See, e.g., Ameritech Comments at 52.



**VII. CONCLUSION**

TWComm urges the Commission to adopt revised rules for interstate access in accordance with these reply comments and its initial comments.

Respectfully submitted,



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